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FISCAL IMPACT STATEMENT

LS 7096 | **NOTE PREPARED:** Jan 13, 2006
BILL NUMBER: HB 1326 | **BILL AMENDED:**

SUBJECT: Single-Factor Apportionment.

FIRST AUTHOR: Rep. Espich | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** | **IMPACT:** State
X **DEDICATED**
FEDERAL

Summary of Legislation: This bill increases, over four years, for purposes of the Adjusted Gross Income Tax, the sales factor used to apportion business income. The bill eliminates the property factor and payroll factor that are also used in apportioning income for taxable years beginning after December 31, 2010.

Effective Date: January 1, 2007.

Explanation of State Expenditures: The transition to a single-factor sales apportionment formula to determine the Indiana Adjusted Gross Income Tax will affect the administration of the tax. The Department of State Revenue will incur additional expenses to revise tax forms, instructions, and computer programs to incorporate the change.

Explanation of State Revenues: *Summary:* The bill provides for a 5-year phaseout (from 2007 to 2011) of the payroll and property factors used to apportion a corporate taxpayer's adjusted gross income (AGI) to Indiana under the AGI Tax. Beginning in 2011, AGI of corporate taxpayers would be apportioned solely on a single sales factor. Based on taxpayer simulations and the current forecast of corporate revenue collections, the change to single-sales-factor apportionment is estimated to result in a net decrease of revenue from the corporate AGI Tax as outlined in the table below.

Fiscal Impact	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Low Range	($2.0 M)	($6.1 M)	($10.4 M)	($14.9 M)	($25.3 M)	($34.0 M)
High Range	($3.1 M)	($10.0 M)	($17.6 M)	($26.2 M)	($45.9 M)	($63.9 M)

Background: The bill phases out the payroll and property factors for purposes of computing corporate Adjusted Gross Income (AGI) Tax. The apportionment formula is used to determine Indiana adjusted gross income for corporations whose income is derived from sources both within and outside Indiana. Currently, a three-factor apportionment formula is used including property, payroll, and sales (also called receipts) to allocate business income to the state. The sales factor is double-weighted so that the payroll and property factors combined represent 50% of the apportionment factor, with sales representing the remaining 50%. The current apportionment formula is shown below.

$$\left[\frac{\text{Indiana Property}}{\text{Total Property}} + \frac{\text{Indiana Payroll}}{\text{Total Payroll}} + 2*\left(\frac{\text{Indiana Sales}}{\text{Total Sales}}\right)\right] \div 4$$

The bill phases out the payroll and property factors by 10% each year from 2007 to 2011. The phaseout schedule is as follows:

	Sales Factor Weight	Combined Weight of Payroll and Property Factors
Current	50%	50%
2007	60%	40%
2008	70%	30%
2009	80%	20%
2010	90%	10%
2011 and after	100%	0%

After the phaseout of the payroll and property factors in 2011, a corporation's income would be allocated to the state based on its Indiana sales as a proportion of its total sales in the United States. The single-sales-factor apportionment formula is presented below:

$$\frac{\text{Indiana Sales}}{\text{Total Sales}}$$

Corporate AGI taxes are distributed to the General Fund. In FY 2005, $608.4 M was collected in corporate AGI Taxes.

Methodology: The fiscal impact is estimated based on a taxpayer simulation using 2003 Corporate AGI taxpayer information (from the IT 20 returns) and recalculating tax liabilities based on the changes in the apportionment formula. The revenue estimates above are based on the first year that corporate taxpayers were taxed solely on adjusted gross income and not gross receipts. *The extent to which this change in tax policy will alter the corporate tax base and future revenue collections is unknown*. Based on the simulation, the net revenue loss from moving to single-sales-factor apportionment is not the result of all corporate taxpayers experiencing some decline in tax liability. Rather, it is the additive result of some taxpayers experiencing a decrease in tax liability and others experiencing an increase in tax liability that fails to fully offset the total of the tax reductions. The simulations using 2003 taxpayer data resulted in about 2,300 taxpayers experiencing a decrease in net tax liability after credits and about 4,700 experiencing an increase in net tax liability after credits. The simulations also resulted in nearly 28,500 taxpayers being unaffected by the change to single-sales-factor apportionment.

The low-range estimate is the net impact on tax liabilities assuming that the taxpayers experiencing tax liability increases due to single-sales-factor apportionment would not have additional NOL (net operating loss) deduction amounts or tax credit amounts to reduce these higher tax liabilities. Thus, they would utilize the same NOL deduction amounts and tax credit amounts as reported in 2003. The high range is the net impact assuming that some taxpayers experiencing tax liability increases due to single-sales-factor apportionment will have sufficient additional NOL deduction amounts and tax credits to reduce these higher tax liabilities. *It is important to note that the net revenue loss could potentially exceed the high range if all of the taxpayers experiencing increased liabilities are able to utilize additional NOL deduction amounts or tax credits to reduce these higher tax liabilities to zero.*

The tables below summarize the results of the 2003 taxpayer simulations. The table below shows the extent that single-sales-factor apportionment would have affected 2003 Indiana **apportioned income**. A total of 35,396 taxpayers were used for the simulation, with 7,128, or 20%, experiencing an increase in Indiana apportioned income and 4,034, or 11%, experiencing a decrease in apportioned income. The net effect for these taxpayers was a 6% decrease in Indiana apportioned income. A total of 24,234, or 69%, of all the regular C corporate taxpayers experienced no change in Indiana apportioned income.

Effect of Single-Sales-Factor (SSF) Apportionment on Indiana Apportioned Income - 2003 Tax Data*

Apportioned Income	# Affected	Apportioned Income - Current	Apportioned Income Under SSF	Difference	% Diff.	Avg. Diff.
Increase	7,128	$1,703.9 M	$2,265.0 M	$561.1 M	33 %	$78,718
Decrease	4,034	$2,287.0 M	$1,473.1 M	($813.9 M)	(36%)	($201,751)
Total Affected	11,162	$3,990.9 M	$3,738.1 M	($252.8 M)	(6%)	($22,645)
No Change	24,234	$1,290.9 M	$1,290.9 M	$0	0	$0

* This table is the effect on corporate taxpayers fully phased-in single-sales-factor apportionment.

The next table summarizes the impact that single-sales-factor apportionment would have had on 2003 **net tax liabilities** (after credits) for the same group of corporate taxpayers. The simulations resulted in 4,678, or 13%, of the taxpayers experiencing a tax increase and 2,309, or 7%, of the taxpayers experiencing a tax decrease. The net decrease in tax liability for all affected taxpayers would have been about 4%. A total of 28,409, or 80%, of the regular C corporate taxpayers would have experienced no change in net tax liability after credits.

Effect of Single-Sales-Factor (SSF) Apportionment on Net Tax Liability After Credits - 2003 Tax Data*							
Tax Liability	**# Affected**	**# of Payers**	**Current Tax**	**Tax Under SSF**	**Difference**	**% Diff.**	**Avg. Diff.**
Increase	4,678	3,950	$116.0 M	$163.6 M	$47.6 M	41%	$10,683
Decrease	2,309	2,136	$156.9 M	$99.5 M	($57.4 M)	(37%)	($13,473)
Total Affected	6,907	6,086	$272.9 M	$263.1 M	($9.8 M)	(4%)	($6,568)
No Change	28,409	8,819	$87.2 M	$87.2 M	$0	0	$0

* This table is the effect on corporate taxpayers fully phased-in single-sales-factor apportionment.

The last table shows the shift in the share of AGI taxes that would have been paid in 2003 by the three groups of corporations. The simulation results indicate that the share of taxes paid by taxpayers experiencing an increase in liability goes from 32% to 47%. The share for corporations experiencing a reduction in tax liability falls from 44% to 28% of the total.

Taxpayers who's taxes...	% Share under Current Law	% Share under Single Sales
Increase	32%	47%
Decrease	44%	28%
are Unaffected	24%	25%

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of State Revenue.

Local Agencies Affected:

Information Sources: Department of State Revenue.

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